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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-1253

EDWARD M. WALSH, Trustee in Bankruptcy of the Estate of Michael W. Cedor, Bankrupt, *Petitioner*,

vs.

MICHAEL W. CEDOR, Bankrupt, *Respondent*.

JAMES H. RIGGS, Trustee in Bankruptcy of the Estate of Clyde R. James, Bankrupt, *Petitioner*,

vs.

CLYDE R. JAMES, Bankrupt, *Respondent*.

PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit

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Subject Index

	Page
Citations to opinions below	2
Jurisdiction	2
Questions presented	2
Statutes involved	3
Statement of case	3
Reasons for granting a writ	6
a. Summary of reasons	6
b. The decision of the Court of Appeals for the Ninth Circuit is in conflict with the decision of this court in the case of Segal v. Rochelle, 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966), and with the decision of the Court of Appeals for the Sixth Circuit in the case of Aveni v. Richman, 458 F.2d 972 (6th Cir. 1972) cert. den. 93 S.Ct. 129 (Oct. 10, 1972). This conflict has arisen because the Ninth Circuit's decision misconceived the meaning of the decision of this court in Lines v. Frederick, 400 U.S. 18, 91 S.Ct. 113, 27 L.Ed. 2d 124 (1970)	7
c. This case raises important questions of interpretation of the Bankruptcy Act, which are of a recurring nature. Because of their great importance in the administration of the estates of bankrupts, these matters should be decided by the United States Supreme Court. This is especially true because the decision of the Ninth Circuit is in conflict with the entire body of bankruptcy law interpreting §70a(5)	16
d. A further reason for granting a writ is that the Ninth Circuit, by its reference to the District's Court's opinion herein, appears to have determined that an income tax refund is "disposal earnings" as defined in the Consumer Credit Protection Act, 15 U.S.C. §1671, et seq. and has, therefore, decided, erroneously, an additional, important question of federal law which has not been, but should be, settled by this court	20
Conclusion	26

Table of Authorities Cited

Cases

	Pages
Aveni v. Richman, 458 F.2d 972 (6th Cir. 1972), cert. den. 93 S.Ct. 129 (Oct. 10, 1972)	6, 7, 14, 15, 17
In re Cedor, 337 F.Supp. 1103 (D.C. N.D. Cal. 1972)	18
In re Clyde R. James, Bankrupt, 337 F.Supp. 1103 (D.C., N.D. Cal. 1972)	2
In re Jones, 337 F.Supp. 620 (D.C. Minn. 1971)	15
In re Kingswood, 343 F.Supp. 498 (D.C. C.D. Cal. 1972)	15, 24
Lines v. Frederick, 400 U.S. 18, 91 S.Ct. 113, 27 L.Ed.2d 124 (1970)	6, 7, 10, 11, 12, 13, 14, 15, 16, 17
Matter of Evans, 253 Fed. 276 (D.C. W.D. Tenn. 1918)	14
Matter of Wright, 157 Fed. 544 (2d Cir. 1907)	14
Segal v. Rochelle, 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966)	6, 7, 8, 9, 10

Codes

Code of Civil Procedure:	
Sections 690 to 690.29	19
Section 690.1	19
Section 690.2	19
Section 690.4	19
Section 690.7	19
Financial Code, Section 15406	19

Statutes

Bankruptcy Act:	
Section 6 (11 U.S.C. §24)	3, 18, 21
Section 24a (11 U.S.C. §47)	5, 6
Section 39c (11 U.S.C. §67c)	5
Section 70a (11 U.S.C. §110a)	passim
Section 70a(5)	5, 7, 8, 9, 16
Chapter XIII	24
Consumer Credit Protection Act (15 U.S.C.):	
Sections 1601, et seq.	21
Sections 1671, et seq.	2, 7, 20

	Pages
Sections 1671-1677	3, 5, 20, 21
Section 1671(a)(1)	21
Section 1671(a)(2)	22
Section 1672(b)	23
Section 1672(c)	22, 24
Section 1673	23, 24
Section 1673(a)	24, 25
Section 1673(b)(2)	24
Section 1673(b)(3)	25
28 U.S.C. §1254(1)	2

Texts

4A Collier on Bankruptcy (14th ed., 1971):	
Par. 70.03[2]	17
Par. 70.34, p. 447	14

Miscellaneous

Tables of Bankruptcy Statistics for the year ending June 23, 1967; Administrative Office of the U.S. Courts May 31, 1968, p. 5 and Table F1	20

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JAMES H. RIGGS, Trustee in Bankruptcy of the Estate of Clyde R. James, Bankrupt, *Petitioner,*

vs.

CLYDE R. JAMES, Bankrupt, *Respondent.*

PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled matter on December 22, 1972.

CITATIONS TO OPINIONS BELOW

The order entered by the District Court for the Northern District of California which was appealed to the Court of Appeals for the Ninth Circuit is reported under the name, *In the Matter of Michael W. Cedor, Bankrupt; In re Clyde R. James, Bankrupt,* 337 F. Supp. 1103 (D.C., N.D. Cal. 1972).

It is printed in Appendix B hereto, *infra,* p. xii.

The opinion of the Court of Appeals for the Ninth Circuit is printed in Appendix B hereto, *infra,* p. x, and is unreported at this time.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on December 22, 1972 and is printed in Appendix B hereto, *infra,* p. viii. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

I. Is a bankrupt's claim to an income tax refund, arising out of amounts withheld from his salary by his employer prior to bankruptcy, "property" which vests in his trustee in bankruptcy, within the meaning of §70a of the Bankruptcy Act (11 U.S.C. §110a)?

II. Is such an income tax refund "disposable earnings", subject to restrictions on garnishment, under the Consumer Credit Protection Act, 15 U.S.C. §1671, et seq.?

STATUTES INVOLVED

The statutory provisions involved herein are as follows: Bankruptcy Act §6 (11 U.S.C. §24), Bankruptcy Act §70a (11 U.S.C. §110a), and Consumer Credit Protection Act, 15 U.S.C. §§1671-1677. The statutes are set forth in Appendix A hereto.

STATEMENT OF CASE

Petitioner Edward M. Walsh is the trustee in bankruptcy of the estate of respondent Michael W. Cedor, bankrupt, and petitioner James H. Riggs is the trustee in bankruptcy of the estate of respondent Clyde R. James, bankrupt. The two combined cases present identical legal questions, but since the facts of each case are somewhat different, such facts will be separately stated herein.

Respondent Michael W. Cedor filed his voluntary petition in bankruptcy on November 6, 1970. Petitioner Edward M. Walsh was appointed his trustee in bankruptcy. The trustee made demand upon Cedor for the check that was expected from the Internal Revenue Service as a refund of income tax withheld from Cedor's wages during 1970. The tax refund was delivered to the trustee when received, and the trustee paid to Cedor that portion of the tax refund calculated to represent amounts withheld from Cedor's wages after November 6, 1970, the date of bankruptcy; and the trustee retained the sum of $332.00, withheld prior to bankruptcy, for administration in the bankruptcy estate of Cedor.

Respondent Clyde R. James filed his voluntary petition in bankruptcy on December 30, 1970. Petitioner James H. Riggs was appointed his trustee in bankruptcy. James was requested to turn over to the trustee his anticipated refund of income tax arising out of amounts withheld from his wages during the calendar year 1970. Thereafter, James received from the Internal Revenue Service, and turned over to the trustee, a check for $154.00, representing his tax refund.

The refund of wages withheld by James' employer during the calendar year 1970 for income taxes, in excess of the amount of tax for 1970 ultimately found due from James, arose from (a) the fact that the Internal Revenue Code and applicable regulations required withholding of amounts in excess of the tax due, and (b) James deliberately failed to advise his employer of all the exemptions to which he was entitled, thereby increasing the amounts withheld, and the amount of the refund.

Both James and Cedor had each performed, prior to bankruptcy, all the acts necessary to earn the right to their respective income tax refunds.

On June 3, 1971, the Honorable Lynn J. Gillard, Referee in Bankruptcy, issued an Order Denying Motion for Order to Return Exempt Property, which order held that Cedor's claim to his income tax refund, which accrued prior to his bankruptcy, was "property" which vested in his trustee under the provisions of §70a of the Bankruptcy Act, and that said income tax refund was not "disposable earnings" within the purview of the Consumer Credit Protection

Act. On August 17, 1971, the Honorable Robert L. Hughes, Referee in Bankruptcy, issued a similar order. Said orders are printed in Appendix B hereto, *infra*, pp. xii-xiv.

Thereafter, on June 18, 1971, Cedor filed with the United States District Court for the Northern District of California a Petition for Review from said order of Referee Gillard. James filed a similar Petition for Review on August 27, 1971, with respect to said order of Referee Hughes. The District Court had jurisdiction to review the orders under §39c of the Bankruptcy Act (11 U.S.C. §67c). On January 20, 1972, the District Court made its Opinion and Order on Review, vacating and setting aside said Referees' orders, and remanding the matters to the respective Referees for further determination.

The District Court's order held: (1) that the portion of the income tax refund attributable to an excess of withholdings that were required to be made, over the amount eventually determined to be the bankrupt's income tax for the year, is not "property" which passes to the trustee within the meaning of §70a(5) of the Bankruptcy Act; and (2) the portion of the income tax refund attributable to additional withholding made because a wage earner bankrupt advised his employer of fewer personal exemptions than he was entitled to claim (as James did herein) is "property", but is 75 percent exempt under the provisions of the Consumer Credit Protection Act, 15 U.S.C. §§1671 to 1677.

The trustees sought, and were granted, leave to appeal, pursuant to §24a of the Bankruptcy Act (11

U.S.C. §47), by orders of the Court of Appeals filed April 18, 1972, and June 15, 1972, respectively. The latter order consolidated the two appeals. On December 22, 1972, the Court of Appeals affirmed the order of the District Court.

REASONS FOR GRANTING A WRIT

a. Summary of reasons

An important reason for granting a writ of certiorari is that the decision of the Court of Appeals for the Ninth Circuit is in conflict with the decision of this Court in the case of *Segal v. Rochelle,* 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966), and with the decision of the Court of Appeals for the Sixth Circuit in the case of *Aveni v. Richman,* 458 F.2d 972 (6th Cir. 1972), cert. den. 93 S.Ct. 129 (Oct. 10, 1972). Such conflict has arisen because the Ninth Circuit's decision is based upon a misconception of the meaning of the decision of this Court in *Lines v. Frederick,* 400 U.S. 18, 91 S.Ct. 113, 27 L.Ed.2d 124 (1970).

In addition, this case raises important questions concerning the interpretation of the Bankruptcy Act which are of a recurring nature. Because of their great importance in the administration of the estates of bankrupts, these matters should be decided by the United States Supreme Court. This is especially true because the decision of the Ninth Circuit is believed to be in conflict with an entire body of bankruptcy law interpreting §70a of the Bankruptcy Act.

A further reason is that the Ninth Circuit, in determining that an income tax refund is "disposable earnings" as defined in the Consumer Credit Protection Act, 15 U.S.C. §1671, et seq., has decided an additional important question of federal law which has not been, but should be, settled by this Court.

b. The decision of the Court of Appeals for the Ninth Circuit is in conflict with the decision of this Court in the case of Segal v. Rochelle, 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966), and with the decision of the Court of Appeals for the Sixth Circuit in the case of Aveni v. Richman, 458 F.2d 972 (6th Cir. 1972) cert. den. 93 S.Ct. 129 (Oct. 10, 1972). This conflict has arisen because the Ninth Circuit's decision misconceived the meaning of the decision of this Court in Lines v. Frederick, 400 U.S. 18, 91 S.Ct. 113, 27 L.Ed.2d 124 (1970).

This Court held that loss-carryback tax refunds of a bankrupt, are "property" which passes to a trustee in bankruptcy under Bankruptcy Act §70a, in a carefully reasoned opinion in *Segal v. Rochelle, supra.*

On the other hand, in the case at bar, the Ninth Circuit issued an eight line opinion holding, that a very similar asset, namely, a wage earner's income tax refund, is not "property" which passes to the trustee under Bankruptcy Act §70a. The eight line opinion makes no reference to *Segal v. Rochelle.*

In arriving at its decision, in *Segal,* this Court first set forth the test to be applied in determining whether an asset is "property" under Bankruptcy Act §70a(5):

> "The main thrust of § 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end the term 'property' has

been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed. E.g., Horton v. Moore, 6 Cir., 110 F.2d 189 (contingent, postponed interest in a trust); Kleinschmidt v. Shroeter, 9 Cir., 94 F.2d 707 (limited interest in future profits of a joint venture); see 3 Remington, Bankruptcy §§ 1177-1269 (Henderson ed. 1957). However, limitations on the term do grow out of other purposes of the Act; one purpose which is highly prominent and is relevant in this case is to leave the bankrupt free after the date of his petition to accumulate new wealth in the future. Accordingly, future wages of the bankrupt do not constitute 'property' at the time of bankruptcy nor, analogously, does an intended bequest to him or a promised gift—even though state law might permit all of these to be alienated in advance."

Segal, supra, 382 U.S. at 379, 380.

Having given examples of the kinds of property of a bankrupt which pass to his trustee under Bankruptcy Act §70a(5), and the kinds which do not, this Court concluded:

"Turning to the loss-carryback refund claim in this case, we believe it is sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupt's ability to make an unencumbered fresh start that it should be regarded as 'property' under §70a(5)." *Segal, supra,* 382 U.S. at 380.

It would appear clear that one key to determining whether an asset is "property" under §70a is whether

it is "sufficiently rooted in the pre-bankruptcy past," and, thus, should pass to the trustee, or represents "new wealth" which relates to future or post-bankruptcy activities of the bankrupt.

In its discussion of why a bankrupt's loss-carryback refund claim passed to his trustee in bankruptcy, under Bankruptcy Act §70a(5), this Court set forth the elements that must exist at the date of bankruptcy in order for such property to be considered "sufficiently rooted in the pre-bankruptcy past."

> "Temporarily, two key elements pointing toward realization of a refund existed at the time these bankruptcy petitions were filed: taxes had been paid on net income within the past three years, and the year of bankruptcy at that point exhibited a net operating loss."
>
> *Segal, supra,* 382 U.S. at 380.

This Court further elucidated its criteria in contrasting a loss-carryback refund with a loss-carryover refund.

> "Without ruling in any way on a question not before us, it is enough to say that a carryover into post-bankruptcy years can be distinguished conceptually as well as practically. The bankrupts in this case had both prior net income and a net loss when their petitions were filed and apparently would have deserved an immediate refund had their tax year terminated on that date; by contrast, the supposed loss-carryover would still need to be matched in some future year by earnings, earnings that might never eventuate at all."

Therefore, under *Segal,* if a bankrupt, by the date of bankruptcy, has performed all of the acts which give him the right to receive something of value, be it a loss-carryback tax refund, or an income tax refund arising out of amounts withheld from his wages before bankruptcy, then the property is "rooted in the pre-bankruptcy past", and passes to his trustee in bankruptcy. There is no dispute that respondent bankrupts, by the time of bankruptcy, had performed all the acts necessary to earn the right to the income tax refunds. Thus, a clear conflict exists between the decision in *Segal* and the Ninth Circuit's decision before this Court.

Segal was followed by *Lines v. Frederick, supra,* wherein this Court held that vacation pay, payable after the date of bankruptcy, was not "property" under Bankruptcy Act §70a because, in part, it was not "sufficiently rooted in the pre-bankruptcy past". This Court appeared, primarily, to base its decision on that aspect of the *Segal* test dealing with the requirement that the bankrupt have the ability to make an "unencumbered fresh start" after bankruptcy. The basis of this Court's decision is set forth at 400 U.S. 20 as follows:

> "The function of their accrued vacation pay is to support the basic requirements of life for [wage earners] and their families during brief vacation periods or in the event of layoff. Since it is a part of their wages, the vacation pay is 'a specialized type of property presenting distinct problems in our economic system.' Sniadach v. Family Finance Corp., 395 U.S. 337, 340,

89 S.Ct. 1820, 1822, 23 L.Ed.2d 349. Where the minimal requirements for the economic survival of the debtor are at stake, legislatures have recognized that protection that might be unnecessary or unwise for other kinds of property may be required. See, *e. g.*, the Consumer Credit Protection Act, § 301, 82 Stat. 163, 15 U.S.C. § 1671 (1964 ed., Supp. V).

The wage-earning bankrupt who must take a vacation without pay or forgo a vacation altogether cannot be said to have achieved the 'new opportunity in life and [the] clear field for future effort, unhampered by the pressure and discouragement of preexisting debt,' Local Loan Co. v. Hunt, *supra*, which it was the purpose of the statute to provide."

Thus, the "fresh start" of the bankrupts in *Lines v. Frederick* would have been impaired if, after bankruptcy, they had to take a vacation without pay or forego a vacation altogether.

The Ninth Circuit in citing *Lines v. Frederick*, as support for its decision herein, has misconceived the meaning of said case by extending it to a species of property, namely, an income tax refund, which is totally different from vacation pay. Since the sole means of support of a wage earner is usually the salary he actually receives from his employer, whether it be in the form of a weekly paycheck, or vacation pay, when he is on vacation, it would appear that a wage earner is not denied a "fresh start" when an income tax refund is turned over to his trustee in bankruptcy. Where the bankrupt retains

his position of employment after the date of bankruptcy, he continues to receive his salary and other benefits of employment. Moreover, in practical terms, a wage earner normally lives on his take-home pay, i.e., his gross earnings minus withholding taxes, social security contributions, and other deductions from his paycheck.

Further, the vacation pay, in *Lines v. Frederick,* was actually earned after the date of bankruptcy, while the right to receive an income tax refund in the case at bar accrued before bankruptcy. Although the employers of the bankrupts in *Lines v. Frederick,* for the convenience of their bookkeeping records, listed the vacation pay as having been "earned" by labor performed prior to the time of vacation, it is clear that in real economic terms, the vacation pay was, in truth, "earned" during the period of vacation after bankruptcy. This is so, because the purpose of the vacation pay was to support the bankrupts during their vacations when they would not receive any other income from their respective employers.

On the other hand, the income tax refund, herein, represents wages earned in the pre-bankruptcy past, both in bookkeeping and in economic terms. The purpose of the tax withholding laws is to assure that the United States government will receive the full tax due it from every wage earner by the time the tax is due. Therefore, the money from which the tax refund arises is withheld from the actual amount earned by employees during each pay period, and is regu-

larly transmitted to the Internal Revenue Service, during the period of employment.

It is thus clear that the tax refund has no real relation to the bankrupt's ability to support himself and his family after bankruptcy. At the time the refund is paid, the wage earner is still, ostensibly, receiving his salary and other benefits of employment, and the refund is usually considered as something of a windfall to the wage earner.

To the extent that a tax refund is expected, and even relied upon, it is more akin to a forced savings account, which provides extra money to the wage earner, as compared to vacation pay which normally serves as the sole means of support during the vacation period.

Also, unlike the situation in *Lines v. Frederick,* the wage earner has some control over the amount of his tax refund because he can, as did respondent James, fail to advise his employer of all the exemptions to which he is entitled, thereby increasing the amounts withheld, and therefore, the amount of the refund.

Petitioners further submit that this Court should grant petitioners' petition so it can affirm that *Lines v. Frederick,* deals with a unique situation, and should not be extended beyond its basic thrust. Prior to the decision therein, the clear trend in the cases had been to enlarge the coverage of §70a of the Bankruptcy Act to include all, or nearly all, classes of property, including many types of property similar to the in-

come tax refund. Thus, wages earned before bankruptcy were held to pass to the trustee, *Matter of Evans,* 253 Fed. 276 (D.C. W.D. Tenn. 1918), as were commissions, *Matter of Wright,* 157 Fed. 544 (2d Cir. 1907); see Collier on Bankruptcy, Volume 4A par. 70.34, page 447 (14th Edition 1971), for further examples of similar property which passes to the trustee.

While *Lines v. Frederick* held that the asset there involved did not pass to the trustee, petitioners submit that the case was not meant to interrupt the clear trend of prior cases. Thus, several cases decided after *Lines v. Frederick,* have refused to expand that case beyond vacation pay. Foremost among said cases is *Aveni v. Richman, supra,* in which the Sixth Circuit held that the non-exempt portion of a bankrupt's wages, which were accrued, but unpaid, on the date of the filing of the petition, was property which passed to the trustee under Bankruptcy Act §70a. This Court denied certiorari in said case. After setting forth the definitions of "property", the Sixth Circuit, at 458 F.2d 973, 974, determined that earned wages were such property for the following reasons:

> "Earned wages, however, are far different from future wages. Earned wages are normally payable at a fixed time following the rendering of services by an employee, and the occurrence of bankruptcy does not alter the maturity of the employer's obligation to pay. Thus, such wages frequently become available during the bankruptcy proceedings and the statutorily authorized exemptions provide the bankrupt with a purse

from them to meet his basic needs. Bankruptcy accompanied by such an arrangement for exemptions is reasonable to the creditors and is clearly more advantageous to the debtor than to experience, for example, the garnishment of his wages. Certainly, the situation here is in no way comparable to the kind of wage attachment shown in Sniadach v. Family Finance Corp., 395 U.S. 337, 340, 89 S.Ct. 1820, 23 L.Ed.2d 349 (1969), where prejudgment garnishments of the Wisconsin type often worked tremendous hardships on workers with families to support. The Bankruptcy Act is designed to give the bankrupt a fresh start to begin anew, but this concept should not be judicially expanded to include 'property' which would otherwise vest in the trustee. Regular wages earned prior to the bankruptcy 'are sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupt's ability to make an unencumbered fresh start', (Segal v. Rochelle, *supra,* 382 U.S. at 380, 86 S.Ct. at 515), that they should be regarded as 'property' under § 70a(5) which passes to the trustee."

Since pre-bankruptcy wages are the source of a wage earner's income tax refund, a conflict clearly exists between *Aveni v. Richman,* and the case at bar. The Ninth Circuit's bald unsupported statement that no conflict exists is unconvincing. (See Appendix B, *infra,* p. xi.)

Other cases refusing to expand *Lines v. Frederick, supra,* are *In re Jones,* 337 F.Supp. 620 (D.C. Minn. 1971), and *In re Kingswood,* 343 F.Supp. 498 (D.C. C.D. Cal. 1972), which was the companion case before

the Ninth Circuit, to the cases now before this Court on the within petition. Both of the above cases held that income tax refunds are property which passed to the trustee. In fact, the case at bar is the only reported case which has expanded *Lines v. Frederick*, to include a category of property, other than vacation pay.

c. This case raises important questions of interpretation of the Bankruptcy Act, which are of a recurring nature. Because of their great importance in the administration of the estates of bankrupts, these matters should be decided by the United States Supreme Court. This is especially true because the decision of the Ninth Circuit is in conflict with the entire body of bankruptcy law interpreting §70a(5).

Prior to the Ninth Circuit's decision in the present case, the test of what property of a bankrupt passed to his trustee in bankruptcy under Section 70a of the Bankruptcy Act was relatively clear, and easy to administer. Such test assured that the pre-bankruptcy creditors of the bankrupt received the maximum amount possible from the non-exempt assets of the bankrupt, while at the same time assuring that the bankrupt was free, after the date of bankruptcy, to accumulate new wealth. Indeed, this was obviously Congress's purpose in enacting the Bankruptcy Act. It is as if a line were drawn through the bankrupt's life on the date of bankruptcy. All property earned or realized, which is transferable by him or leviable under state law, as of that date, passes to his creditors.

On the other hand, all property earned or realized by the bankrupt's efforts, after the date of bank-

ruptcy, is his to keep. Because the line in time drawn by §70a is an arbitrary one, there are bound to be instances where the bankrupt has earned some compensation or realized something of value before the date of bankruptcy, but has not yet received it. The Courts have uniformly held that such property passes to the trustee in bankruptcy. Their view is supported by the leading commentary on bankruptcy law (see Volume 4A, *Collier on Bankruptcy,* Par. 70.03[2], 14th Ed. 1971). Such test is clearly consistent with the purpose and scheme of the Bankruptcy Act.

This universally accepted test is apparently abandoned by the Ninth Circuit, in the present case, and the whole body of prior law is disregarded. The Ninth Circuit's decision causes grave difficulties in the administration of estates of bankrupts, because, it does not set forth any new standard which can be utilized by trustees in bankruptcy and Bankruptcy Courts to determine whether or not various assets pass to the trustee.

In fact, the eight line opinion offers no guidance and has created widespread disagreement and questions with respect to its application in bankruptcy proceedings now pending. This is to be expected because the opinion claims to rely on *Lines v. Frederick, supra,* which involved an asset of a totally different nature, while, at the same time, it baldly, and without explanation, states that it does not conflict with *Aveni v. Richman, supra,* which involves a very similar type of asset. The confusion is multiplied by virtue of the fact that the decision affirms a Dis-

trict Court opinion, *In re Cedor,* 337 F.Supp. 1103 (D.C. N.D. Cal. 1972), which purports to expand the exemption provisions of the Bankruptcy Act (Bankruptcy Act §6), without defining their limits, so that the Ninth Circuit's decision might well be considered a precedent for holding exempt virtually all assets of a bankrupt. In the same vein, the District Court's opinion seems to imply that a bankrupt is not required to turn over an income tax refund, or any other property, to his trustee in bankruptcy, if he can show that he will be, in some way, inconvenienced by having to do so.

If that is the basic test of the Ninth Circuit in the case at bar, such test suffers from severe defects. A debtor could file bankruptcy, be discharged of his debts, and retain all of his property because it is almost always a hardship for a debtor to be deprived of anything of value. Creditors, on the other hand, would receive nothing. Under such conditions, it is not hard to imagine a great increase in bankruptcies by persons seeking to take advantage of the new doctrine enunciated by the Ninth Circuit. It should also be emphasized that to be deprived of an income tax refund is not a severe hardship since the Bankruptcy Act does protect property of the bankrupt which is deemed necessary to the bankrupt, so that he can earn a living and maintain himself and his family.

Bankruptcy Act, Section 6 states:

> "Exemptions of Bankrupts. This Act shall not affect the allowance to bankrupts of the exemptions which are prescribed by the laws of the

United States or by the State laws in force at the time of the filing of the petition . . ."

In the State of California, California Code of Civil Procedure §§690 to 690.29 list a wide variety of items of property which are exempt from the claims of creditors and the trustee in bankruptcy. For example, Code of Civil Procedure §690.7 exempts a savings account in the amount of $1,000.00, while California Financial Code §15406 exempts deposits in a credit union up to the amount of $1,500.00, thereby providing a bankrupt with a potential "nest egg" in the amount of $2,500.00 to be utilized after the date of bankruptcy. Further, the bankrupt retains his basic necessities of life in that necessary household furnishings, appliances, and wearing apparel are exempt under Code of Civil Procedure §690.1, and an automobile of a certain maximum value is exempt under Code of Civil Procedure §690.2. A bankrupt's right to earn a living is further protected by Code of Civil Procedure §690.4 which exempts all personal property ordinarily and reasonably necessary to, and personally owned and used by, the bankrupt exclusively in the exercise of the trade, calling, or profession by which he earns his livelihood, up to the maximum aggregate actual cash value of $2,500.00, over and above all liens and encumbrances on such property, as of the date of bankruptcy.

Thus, it can be seen that the bankrupt's "fresh start" is amply protected by the Bankruptcy Act and state law.

Finally, the questions raised by the Ninth Circuit's opinion are of a recurring nature and will affect thousands of bankrupts over the ensuing months and years. For example, 9,103 bankruptcy petitions were filed in the Northern District of California, alone, in the fiscal year 1967. Of this total, about 92%, or 8,375, can be assumed to be nonbusiness petitions[1], in which an income tax refund due to the bankrupt is potentially present.

The Ninth Circuit's decision potentially affects every case arising under the Bankruptcy Act, with respect to all kinds of property, and the questions raised thereby are of crucial importance in the administration of estates in bankruptcy.

d. A further reason for granting a writ is that the Ninth Circuit, by its reference to the District Court's opinion herein, appears to have determined that an income tax refund is "disposal earnings" as defined in the Consumer Credit Protection Act, 15 U.S.C. §1671, et seq. and has, therefore, decided, erroneously, an additional, important question of federal law which has not been, but should be, settled by this Court.

This Court should grant petitioners' petition in order to decide that the Consumer Credit Protection Act (15 U.S.C. §§1671-77) does not apply to income tax refunds.

The District Court held that the part of the tax refund that results from the bankrupt's voluntary

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[1]Source: Tables of Bankruptcy Statistics for the year ending June 23, 1967; Administrative Office of the U.S. Courts May 31, 1968, page 5 and Table F1.

authorization of withholding, in excess of the amount required by law, is property within the meaning of §70a of the Bankruptcy Act, but that 75% of it is exempt under Subchapter II—Restrictions On Garnishment (15 U.S.C. §1671 through §1677) of the Consumer Credit Protection Act (15 U.S.C. §1601, et seq.). The District Court reasoned that the order of the Referee in Bankruptcy requiring the bankrupt to turn over to the trustee his tax refund check constitutes a "garnishment", and the excess tax refund attributable to optional withholding is "disposable earnings". Hence, the Court concluded, the Act's restriction on garnishment makes this part of the refund "exempt" property that the bankrupt is entitled to retain under §6 of the Bankruptcy Act (11 U.S.C. §24). Petitioners respectfully submit that the Consumer Credit Protection Act is not applicable to an income tax refund arising out of amounts withheld from the wages of a debtor.

The clear purpose of the Restrictions on Garnishment provisions, 15 U.S.C. §§1671 to 1677, is to prevent creditors from garnishing so large a percentage of wages earned, but not yet paid, that a debtor is deprived of the means of supporting himself and his family, and is in danger of being dismissed by his employer.

Thus, §1671(a)(1), the declaration of purpose section, speaks of preventing the unrestricted garnishment of compensation due for personal services which encourages the making of predatory extensions of

credit, and §1671(a)(2) speaks of preventing the loss of employment by a debtor which results from the application of garnishment as a creditor's remedy.

Clearly, this refers to the traditional levy by a creditor upon the debtor's employer, to reach wages earned, but not yet paid. The chance of garnishing an income tax refund check would hardly serve to encourage extensions of credit; and the debtor's employer would not normally be aware of any attempt by a creditor to reach a debtor's income tax refund.

Further, a Referee's turnover order is not a "garnishment". Wage garnishment connotes a court sanctioned direction to an employer, at the instance of an employee's creditor, requiring the employer to pay to the creditor wages due the employee. Section 1672(c) defines "garnishment" as "any legal or equitable procedure through which the earnings of an individual are required to be withheld for payment of any debt." The conclusion that this definition includes a Referee's order directing a bankrupt to turn over his tax refund to the trustee requires that the word "withheld" be ignored. The question of when wages cease to be identified as such—when paid, or when deposited in a bank account, or when invested by purchase of an asset that creditors might reach—is a familiar one. The statutory definition of §1672(c) answers this question by its use of the word "withheld". The definition, and the federal restrictions on garnishment, are directed toward the traditional concept of wage garnishment, to wit, an order requiring an employer to

withhold money from an employee's wages and to pay it to the levying officer for disbursement to the employee's creditor.

Further, the Consumer Credit Protection Act does not govern the present situation because the tax refund paid to the bankrupt by the Internal Revenue Service is not "disposable earnings". §1673 provides that "the maximum part of the aggregate disposable earnings of an individual for any workweek" that can be taken by garnishment is "25 per centum of his disposable earnings for that week". "Disposable earnings" is defined by §1672(b) as "that part of the earnings of any individual remaining after the deduction from those earnings of any amounts required by law to be withheld." Here, of course, the tax refund came from the withholdings that were made for the payment of income tax, and not from disposable earnings remaining after the deduction of the amounts required to be withheld for income tax. The District Court reasoned, however, that since respondent James had not claimed all of the exemptions to which he was entitled, the resulting excess withholding was not "required by law". This conclusion is erroneous because once the employee has advised his employer how many exemptions he claims, the employer is required by law to calculate the deduction on that basis, and withhold it for payment to the Internal Revenue Service.

Moreover, as the Referee observed, in considering whether the Consumer Credit Protection Act is applicable to an income tax refund:

> "Since the amount withheld by the employer for taxes of the employee had lost its status as wages it became merely a potential claim for a tax refund. Such monies withheld cannot logically reassume the character of wages after the employer pays such monies to the government."
> *In re Kingswood, supra,* 343 F.Supp. at 502.

Further, the statute's exception for orders under Chapter XIII of the Bankruptcy Act does not indicate a Congressional intent to make the restrictions on garnishment applicable to income tax refunds. The District Court found support for its interpretation of the statute in the provisions of §1673(b)(2), that the §1673(a) restrictions on garnishment do not apply to "any order of any Court of bankruptcy under Chapter XIII of the Bankruptcy Act." In the opinion of the District Court, "the orders reviewed in the present proceedings are the same as a Court might make in a Chapter XIII proceeding." Actually, the Chapter XIII order referred to in §1673 is much different. It is an order requiring the debtor's employer to send all or part of the debtor's wage check directly to a Chapter XIII trustee, rather than to the debtor employee. (The order is designed to enforce the debtor's agreement to make the periodic payments to his Chapter XIII trustee called for by his plan of arrangement.) Since this order fits within the §1672(c) definition of garnishment, the statute's exception of such orders is needed. However, an additional exception for an order directing a bankrupt to turn over his tax

refund check is not called for, because such order does not remotely come within the statutory definition or concept of a wage garnishment.

Further, under the decision of the Ninth Circuit, the question of whether a bankrupt or his trustee is entitled to an income tax refund would appear to turn upon the presence or absence of tax debts. §1673(b)(3) provides that the restrictions on garnishment of §1673(a) do not apply in the case of "any debt due for any State or Federal Tax." Thus, a bankrupt, who at the time of bankruptcy, did not owe any state or federal taxes would be entitled to claim an exemption, while a bankrupt who does owe any such tax would not. It does not seem reasonable to assume that Congress intended such a distinction. This Court should grant certiorari in order to assure that the statute is interpreted in a way that avoids such an unreasonable distinction. The statute should be interpreted as urged by petitioners—that the Consumer Credit Protection Act's restrictions on garnishment are not applicable to a Referee's order directing a bankrupt to turn over to his trustee his income tax refund.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiarari should be granted.

Dated, San Francisco, California,
March 5, 1973.

Respectfully submitted,
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Counsel for Petitioners, Edward M. Walsh, Trustee in Bankruptcy of the Estate of Michael W. Cedor, Bankrupt, and James H. Riggs, Trustee in Bankruptcy of the Estate of Clyde R. James, Bankrupt.

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(Appendices Follow)

Appendix A

The statutory provisions involved herein are as follows: Bankruptcy Act §6 (11 U.S.C. §24), which states:

"This title shall not affect the allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws in force at the time of the filing of the petition in the State wherein they have had their domicile for the six months immediately preceding the filing of the petition, or for a longer portion of such six months than in any other State: *Provided, however,* That no such allowance shall be made out of the property which a bankrupt transferred or concealed and which is recovered or the transfer of which is avoided under this title for the benefit of the estate, except that, where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such allowance may be made out of such excess."

Bankruptcy Act §70a (11 U.S.C. §110a), which states:

"(a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trade-marks, and in ap-

plications therefor: *Provided,* That in case the trustee, within thirty days after appointment and qualification, does not notify the applicant for a patent, copyright, or trade-mark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted unless for cause shown by the trustee the court grants further time to the trustee for making such election; and such applicant may, in any event, at any time petition the court to be revested with such title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: *Provided,* That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process: *And provided further,* That when any bankrupt, who is a natural person, shall

have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this title, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

All property, wherever located, except insofar as it is property which is held to be exempt, which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date when it vested in

the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.

All property, wherever located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy.

The title of the trustee shall not be affected by the prior possession of a receiver or other officer of any court."

Consumer Credit Protection Act, 15 U.S.C. §1671, entitled "Congressional Findings and Declaration of Purpose", states:

(a) The Congress finds:

(1) The unrestricted garnishment of compensation due for personal services encourages the making of predatory extensions of credit. Such extensions of credit divert money into excessive credit payments and thereby hinder the production and flow of goods in interstate commerce.

(2) The application of garnishment as a creditors' remedy frequently results in loss of employment by the debtor, and the resulting disruption of employment, production, and consumption constitutes a substantial burden on interstate commerce.

(3) The great disparities among the laws of several States relating to garnishment have, in effect, destroyed the uniformity of the bankruptcy laws and frustrated the purposes thereof in many areas of the country.

(b) On the basis of the findings stated in subsection (a) of this section, the Congress determines that the provisions of this subchapter are necessary and proper for the purpose of carrying into execution the powers of the Congress to regulate commerce and to establish uniform bankruptcy laws."

C.C.P.A., 15 U.S.C. §1672, entitled, "Definitions", states:

"For the purpose of this subchapter:

(a) The term 'earnings' means compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension or retirement program.

(b) The term 'disposable earnings' means that part of the earnings of any individual remaining after the deduction from those earnings of any amounts required by law to be withheld.

(c) The term 'garnishment' means any legal or equitable procedure through which the earnings of any individual are required to be withheld for payment of any debt."

C.C.P.A., 15 U.S.C. §1673, entitled, "Restrictions on Garnishment—Maximum Allowable Garnishment", states:

"(a) Except as provided in subsection (b) of this section and in section 1675 of this title, the

maximum part of the aggregate disposable earnings of an individual for any workweek is subjected to garnishment may not exceed

(1) 25 per centum of his disposable earnings for that week, or

(2) the amount by which his disposable earnings for that week exceed thirty times the Federal minimum hourly wage prescribed by Section 206(a) (1) of Title 29 in effect at the time the earnings are payable.

whichever is less. In the case of earnings for any pay period other than a week, the Secretary of Labor shall by regulation prescribe a multiple of the Federal minimum hourly wage equivalent to that set forth in paragraph (2).

Exceptions

(b) The restrictions of subsection (a) of this section do not apply in the case of

(1) any order of any court for the support of any person.

(2) any order of any court of bankruptcy under chapter XIII of the Bankruptcy Act.

(3) any debt due for any State of Federal tax.

Execution or enforcement of garnishment order or process prohibited

(c) No court of the United States or any State may make, execute, or enforce any order or process in violation of this session."

C.C.P.A., 15 U.S.C. §1674, entitled, "Restriction on Discharge From Employment by Reason of Garnishment", states:

(a) No employer may discharge any employee by reason of the fact that his earnings have been subjected to garnishment for any one indebtedness.

(b) Whoever willfully violates subsection (a) of this section shall be fined not more than $1,000, or imprisoned not more than one year, or both."

C.C.P.A., 15 U.S.C. §1675, entitled, "Exemption for State-Regulated Garnishments", states:

"The Secretary of Labor may by regulation exempt from the provisions of section 1673(a) of this title garnishments issued under the laws of any State if he determines that the laws of that State provide restrictions on garnishment which are substantially similar to those provided in section 1673(a) of this title."

C.C.P.A., 15 U.S.C. §1676, entitled, "Enforcement by Secretary of Labor", states:

"The Secretary of Labor, acting through the Wage and Hour Division of the Department of Labor, shall enforce the provisions of this subchapter."

C.C.P.A., 15 U.S.C. §1677, entitled, "Effect on State Laws", states:

"This subchapter does not annul, alter, or affect, or exempt any person from complying with, the laws of any State

(1) prohibiting garnishments or providing for more limited garnishments than are allowed under this subchapter, or

(2) prohibiting the discharge of any employee by reason of the fact that his earnings have been subjected to garnishment for more than one indebtedness."

Appendix B

United States Court of Appeals
For the Ninth Circuit

No. 72-1483
No. 72-2311

In the Matters of
Clyde R. James,
Bankrupt,
and
Michael W. Cedor,
Bankrupt.

James H. Riggs,
Trustee and Appellant,
vs.
Clyde R. James,
Bankrupt and Appellee.

Edward M. Walsh,
Trustee and Appellant,
vs.
Michael W. Cedor,
Bankrupt and Appellee.

Appeal from the United States District Court
for the Northern District of California

JUDGMENT

This Cause came on to be heard on the Transcript of the Record from the United States District Court

for the Northern District of California and was duly submitted.

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered December 22, 1972

x

United States Court of Appeals
For the Ninth Circuit

No. 72-1483
No. 72-2311

In the Matters of
Clyde R. James,
Bankrupt,
and
Michael W. Cedor,
Bankrupt.

James H. Riggs,
Trustee and Appellant,
vs.
Clyde R. James,
Bankrupt and Appellee.

Edward M. Walsh,
Trustee and Appellant,
vs.
Michael W. Cedor,
Bankrupt and Appellee.

[Filed December 22, 1972]

Appeal from Orders of the United States District Court for the Northern District of California

Before: BARNES, KOELSCH, and ELY, Circuit Judges.

PER CURIAM:

The challenged Order of the District Court are affirmed upon the authority of *Lines v. Frederick,*

400 U.S. 18 (1970), and the carefully reasoned opinion of District Judge Wollenberg. *In re Cedor,* 337 F. Supp. 1103 (D.C.N.D. Cal. 1972).

We cannot see that our opinion in any way conflicts with *In re Aveni,* 458 F.2d 972 (6th Cir. 1972). There, a clearly different problem was presented.

United States District Court
For the Northern District of California

No. 2-70-287
No. 2-70-288
IN BANKRUPTCY

In the Matter of
Michael W. Cedor and
Sue Barbara Cedor,
Bankrupts

[Filed June 9, 1971]

ORDER DENYING MOTION FOR ORDER TO RETURN EXEMPT PROPERTY

The motion of the above entitled bankrupts for an order requiring Edward M. Walsh, Trustee herein, to return to the bankrupts a portion of the bankrupts' income tax refund for the taxable year 1970 on the grounds that said amount claimed represents disposable earnings of the bankrupts exempt to them pursuant to 15 U.S.C. §1671, et seq., having come on regularly for hearing before the undersigned Referee in Bankruptcy on the 19th day of May, 1971, the bankrupts appearing by one of their attorneys, Thomas R. Adams, the Trustee appearing in propria persona, and the Court having considered the matters alleged in the bankrupts' motion and the Trustee's response thereto, together with the memoranda of

points and authorities submitted by the parties, and no evidence having been submitted by the parties, the facts not being in controversy, an it appearing from the record herein that the bankrupts filed their petitions in bankruptcy with this Court on the 6th day of November, 1970, that on April 19, 1971, the bankrupts delivered to said Trustee on demand their 1970 federal income tax refund check in the sum of $412.00, that thereafter said Trustee, delivered to the bankrupts the sum of $79.02, being the amount of the said tax refund attributable to the portion of the taxable year remaining after November 6, 1970, from which facts the Court concludes, as a matter of law, that the term "disposable earnings", as the same is set forth in 15 U.S.C. §1672(b), does not extend to, nor include sums withheld by the employer of the bankrupts for the payment of federal income taxes and subsequently returned to the bankrupts in whole or in part as a federal income tax refund; and further, that title to the portion of the federal income tax refund retained by the said Trustee passed to the said Trustee upon the filing of the petitions in bankruptcy herein pursuant to the provisions of §70 of the Bankruptcy Act, and good cause appearing therefor,

It Is Ordered that the motion of the bankrupts be, and the same is hereby DENIED.

Dated: June 9, 1971.

/s/ Lynn J. Gillard
Lynn J. Gillard
Referee in Bankruptcy

Robert R. Barton
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Oakland, California 94607
Tel: 834-5300
Attorney for Trustee

In the United States District Court
For the Northern District of California

In the Matter of Clyde R. James, Bankrupt, and Joyce M. James, Bankrupt.	In Bankruptcy No. 3-70-1064 and No. 3-70-1065

[Filed August 17, 1971]

ORDER DENYING MOTION

The Motion For Order To Return Exempt Property filed herein by the above named bankrupts, seeking an order that the Trustee return to them three-fourths or all of the $154.00 received as refund of withheld income tax, came regularly on for hearing on August 12, 1971; Ralph L. Jacobson and Michael H. Weiss appeared as counsel for the bankrupts, and Robert R. Barton appeared as counsel for the Trustee. Upon the papers which accompanied the motion, the Statement of Facts and the affidavit filed on behalf of the bankrupts at the hearing, and the stipulation made by the parties on open Court that Mr. James

claimed, with respect to the earnings and tax withholdings that led to the refund, less personal and dependent exemptions than he was entitled to claim, and the matter having been submitted,

It Is Hereby Ordered that said motion be and the same hereby is denied.

Dated: August 17, 1971

/s/ Robert L. Hughes
Referee in Bankruptcy

In the United States District Court for the Northern District of California

Case No. 2-70 287 ACW
and
Case No. 3-70 1064 ACW

In the Matters of
Michael W. Cedor,
Bankrupt.
and
Clyde R. James,
Bankrupt,

[Filed January 20, 1972]

OPINION AND ORDER ON REVIEW

These two cases were consolidated for purposes of argument; both present the same issues, involved in the administration of estates of bankrupts who were wage-earners prior to filing. In each case, the bankrupt's wages were subject to withholding for federal income tax. In each case, the bankrupt's employer withheld from his earnings the amount required by the statement filed by the bankrupt under the provisions of the Internal Revenue Code, 26 U.S.C. §§3401-3402. In each case, the tax return filed by the bankrupt showed a tax liability owing in an amount less than the amount actually withheld, so that a refund was due and eventually was paid to the bankrupt after the date his petition was filed. The trustee

in each case asserted his claim to that portion of the refund attributable to earnings preceding the date of filing, and that amount is now held by the trustee. Each bankrupt moved to recover at least a portion of that sum, and it is from the denial of the motion by the referee that these petitions for review are brought. One difference between the two cases is that in *Cedor* the motion was for return of seventy-five percent of the sum turned over to the trustee, and the argument to the referee in effect conceded that the remaining twenty-five percent was properly an asset of the estate, while in *James* the contention was that the bankrupt should recover the total amount of the tax refund. It was in his brief on review in this court that the bankrupt in *Cedor* claimed the total amount for the first time.

The bankrupt in each cases bases his claim on two theories. First it is urged that the rationale of *Lines v. Frederick,* 400 U.S. 18 (1970), requires that the amount of the tax refunds in these cases be construed not to be "property" within the meaning of §70(a)(5) of the Act, 11 U.S.C. §110(a)(5), with the result that title would not pass to the trustee. As an alternative rationale, the bankrupts argue that taking title to the refund in these cases constitutes a "garnishment" by the trustee, as that term is defined in the Consumer Credit Protection Act, 15 U.S.C. §§ 1671-77. As such, the trustee would be entitled, it is argued, to no more than twenty-five percent of the portion of the refund attributable to pre-filing earnings. Both issues require careful consideration.

The decision of the Supreme Court in *Lines v. Fredrick* turned upon a careful consideration of the nature of the fund to which the trustee was asserting title, with a view to determining how closely the fund was linked, on the one hand, with the pre-bankruptcy past, and to what extent it was tied to the bankrupt's ability in fact to make the fresh, unencumbered start envisioned by the Bankruptcy Act. In that case the Court was dealing with vacation pay which was accrued but unpaid at the time of filing. There was no means by which the bankrupt could reach the fund prior to the taking of his annual leave or the termination of his employment. Similarly, there is no means by which the wage-earner can recover any portion of moneys withheld on account of the federal income tax prior to the filing of his tax return. The Court concluded in *Lines* that it would be an undue burden to require the bankrupt to either forego his annual vacation period or to force him to take the vacation without pay. This conclusion was supported by a reference to *Snaidach v. Family Finance Co.*, 395 U.S. 337 (1969), which recognized wages as "a specialized type of property presenting distinct problems in our economic system". 395 U.S. 340. That reasoning led the Court in *Lines* to distinguish vacation pay from the refund generated by the "loss-carryback" provisions of the Internal Revenue Code relating to taxation of business income which the Court had earlier held to be "property" in *Segal v. Rochelle*, 382 U.S. 375 (1966); as "property", the refund was subject to the provisions of §70(a), passing title to the trustee.

Here the Court is confronted with elements of both *Segal* and *Lines*. The funds are received as a tax refund, but the refund is generated by the provisions of the Internal Revenue Code requiring certain amounts to be withheld from wages under given circumstances. In *Segal* the refund amounted to the recovery of a part of the taxes paid on profits in earlier years because of losses in the operation of a business in the taxable year; those losses also were a precipitating cause of the bankruptcy. In the instant case, the Court is concerned with the refund of what was, in effect, a *forced* overpayment of tax *on wages*. There is nothing to suggest that the sums refunded were related to the circumstances which precipitated the bankruptcy. The Supreme Court considered the question in *Segal* to be "close", 382 U.S. 379; in light of *Lines* and *Snaidach*, the balance on this question tips in favor of the bankrupt. The collection by the Internal Revenue Service without the consent or control of the bankrupt, and the belated refund, render these funds quite similar in a practical sense, to the accrued but unpaid wages which constituted vacation pay. In *Lines* stands for anything, it is that the practical realities are controlling in this determination. While the amount of refund is not so easy to calculate as the amount of vacation pay, it may generally be said to be an amount that, by reason of past experience, is anticipated by the wage-earner as an annual event. To deprive the wage-earner of that planned-on annually recurring payment, cannot be said to be less severe than the depriva-

tion of two weeks of paid vacation, in terms of a fresh start. The Court concludes therefore, that insofar as the tax refund to a bankrupt is attributable to an excess of the *minimum* amount required by law to be withheld from the bankrupt's wages over the amount of the bankrupt's actual tax liability, the refund is not property within the meaning of §70(a)(5) of the Act.

But a significant distinction between accrued but unpaid vacation pay, and the refunds considered in at least one of these cases appears from the record. In the *James* case, the bankrupt authorized withholding in an amount greater than the minimum required by the Internal Revenue Code. Summary of Record Below and Stipulation Thereto. The flexibility of the withholding provisions, no doubt, serves many salutary purposes, primarily as a means of assuring that enough will in fact be withheld to meet the tax liability of a given individual. But that flexibility is a factor which is not present in the usual case of vacation pay, considered by the Supreme Court in *Lines;* there the individual employee does not control the amount accrued. The accrual is determined by the employer, and the employee does not have the option of either drawing down the vacation pay, or some part of it, in advance of the vacation period, or of causing additional sums to be withheld from his regular pay to be set aside in the vacation pay account.

Given these characteristics, there would be little utility in the employment of vacation pay as a means of defeating creditors in the first instance, and later

defeating the trustee in bankruptcy. On the other hand, it is not at all difficult to conceive of an astute candidate for bankruptcy drastically increasing the amount of withholding for taxes, in view of impending financial difficulties, given the knowledge that the refund eventually obtained after filing bankruptcy would be free of the claims of creditors and the trustee as well. To the extent that the refund is attributable to optional withholding, the amount of which is controlled by the decision of the bankrupt, the analogy to *Lines* fails.

If a refund is held to be "property" within the meaning of §70(a) of the Act, to the extent that it is attributable to the optional withholding, an additional question must be answered in resolving the issue of whether the refund is, to some extent at least, an asset of the estate. §70(a)(5) provides that the trustee takes title to property which the bankrupt ". . . could have by any means transferred . . .", and so if the trustee would prevail, the bankrupt's interest in the tax refund must be found to be transferrable at the time the petition is filed. This determination involves preliminary consideration of the so-called Anti-Assignment Act, 31 U.S.C. §203, which purports to bar any assignment of claim against the United States before the claim is liquidated and the warrant issued. It has been held, however, that §203 does not impair the validity of an assignment of a claim against the government as between the parties, and that between them, the question is one of state law. *Segal v. Rochelle, supra,* 382 U.S. at 384 and cases there cited.

The bankrupts in the present cases do not contend that the claims are not transferrable, and under California law there would appear to be ample support for that concession. See, *In re Goodson,* 208 F.Supp. 837 (S.D.Cal. 1962). That case determined that under California law, equity would enforce such a transfer as between the parties, although it would probably not be legally enforceable. It was precisely that test which the Supreme Court used in *Segal* to hold the interest in the refund transferrable within the meaning of §70(a)(5). To the extent that the refund is attributable to withholding in excess of the minimum required, it must be held to pass to the trustee upon filing of the petition.

The trustee, of course, takes title subject to whatever exemptions the bankrupt may be entitled to assert. §§70(a), and 6 of the Act, 11 U.S.C. §§110(a), and 24. The bankrupts' second argument is that a portion of the refund attributable to such optional withholding is exempt. The bankrupts contend that, on these facts, the taking of title to the refund check by the trustee constitutes a "garnishment", as that term is defined in the Consumer Credit Protection Act, 15 U.S.C. §§1671-77, at 1672(c).

Under the provisions of Subchapter II of that Act as applied to these bankrupts, the garnisher can take only twenty-five percent of the "disposable earnings" of the debtor. "Disposable earnings" is the balance remaining after all deductions "required by law to be withheld" from earnings are made. 15 U.S.C. §1672(b).

The argument is that an order of the referee in bankruptcy requiring the bankrupt to turn over a tax refund check traceable to wages constitutes a garnishment; admittedly, that theory seems somewhat strained at first glance. It is clear, however, that the source of the funds constituting the refund is within the meaning of the term "earnings" as it is defined in §1672(a). There does not appear to be any reason of policy why the amount of the refund should be held to have lost its character as "earnings" by reason of its somewhat circuitous route to the wage-earner's hands. The entire amount of the refund would come within the definition of "disposable earnings" since nothing would be withheld. "Garnishment" is defined in §1672(c) as "any legal or equitable procedure through which the earnings of any individual are required to be withheld for the payment of any debt". The process by which the trustee takes title is certainly "a legal or equitable procedure", and the purpose of requiring the trustee to marshal the assets of the bankrupt is to pay the debts of the bankrupt. If it would be inequitable to allow the bankrupt to defeat his creditors and the trustee by the simple expedient of increasing the level of withholding for taxes, so also it would seem unfair to punish the wage earner, who elects to have a portion of his wages set aside through income tax withholding, by allowing all of the withheld wages in excess of actual tax liability to be taken by creditors or their representative, the trustee. It is in the national interest, according to the provisions of the Internal Revenue Code, to

have taxpayers make certain that enough is witheld, so that taxes are promptly paid. The taxpayer is encouraged to err on the side of over-withholding. A decision here that all excess withholding must go to the trustee in bankruptcy would certainly tend to frustrate the objective of the withholding laws.

The middle course seems indicated. With respect to that part of the refund which is attributable to optional or elective withholding, that withholding in excess of the minimum required by law, should continue to receive the characterization required by its source—wages—and pass to the trustee subject to the same exemptions as do wages.

That conclusion is strengthened by the fact that §1673(b) which enumerate the exceptions to the rule limiting the amount of garnishment, specifically deals with orders of bankruptcy courts. 15 U.S.C. §1673(b)(2) provides: "any order of any court of bankruptcy *under Chapter XIII* of the Bankruptcy Act [emphasis supplied]" is excepted from the restrictions set out in the Subchapter. Chapter XIII is not, of course, involved in these "straight" bankruptcy proceedings. Under accepted canons of statutory construction, the mention of one specific type of bankruptcy proceeding must be taken by implication to exclude other types of proceedings. In addition, the statute is clearly remedial in general purpose. The exceptions to its coverage should, therefore, be strictly construed. From a slightly different perspective, unless the §1673(b)(2) exception of orders in Chapter XIII proceedings is surplusage, Congress must have

intended that the Act's restrictions on garnishment should apply to other, similar orders of the bankruptcy court not within the terms of the exception. From the standpoint of exercise of judicial power, the orders reviewed in the present proceedings are the same as the court might make in a Chapter XIII proceeding. The trustee, in his brief, offers no other rationale to explain the specific exception of §1673(b)(2).

The bankrupts point out that the agency charged with the administration of Subchapter II of the Protection Act, the Wage and Hour Division of the Department of Labor, appears to follow the construction of the Act which the bankrupts urge. The letter of Robert D. Moran, Administrator, attached to the bankrupts' brief as "Exhibit A", states in part: The exemption in section 303(b)(2) [15 U.S.C. §1673(b)(2)] of the Act runs only to orders of the Bankruptcy Court under Chapter XIII. Any other order of a Bankruptcy Court would appear subject to the garnishment restrictions provided in section 303(a)[1673(a)]." The construction of the administering agency is entitled to great weight. *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1968), and cases cited therein. That construction certainly bolsters the other considerations discussed above.

No particular difficulty accompanies the administration of such a rule. The bankrupt must schedule his claim of exemption in any event. It will, therefore, be the election of the bankrupt to claim simply the protection of the Consumer Credit Protection Act, or to

take the additional step and seek to establish that a portion of the refund, at least, was attributable to excessive minimum withholding. The information on levels of withholding is generally available, so that it would not be difficult for the trustee to verify the claim made. As a practical matter, many fewer persons will stand to benefit from the holding of total protection for funds attributable to excessive minimum withholding, than will benefit from the second aspect of this decision, with regard to which no administrative difficulty will be encountered.

As previously noted, one additional difficulty remains in the *Cedor* matter. Should the failure of the bankrupts to argue the *Lines v. Fredrick* rationale in proceedings before the referee prevent them from raising that issue here? The question is clearly one which is subject to the discretion of the district court. Because of the consolidation of these two matters, no judicial economy has been able to be effected by refusing to consider the issue that was not briefed and argued before the referee. There would seem to be no reason to bar these bankrupts now from the benefit of the rule here announced. Accordingly, it is

ORDERED that the referee's orders in each of these matters denying the bankrupts' motions are vacated and set aside. The matters are remanded to the referee so that the bankrupts may properly schedule the amounts of the refund attributable to the excess of minimum withholding over the tax actually due, and claim that amount as an asset not passing to the trustee. In the event that the bankrupts elect

not to make such a claim, or are not able to establish such a claim when made, then the respective motions for return of the amount of the tax refund shall be granted to the extent of seventy-five percent of the total sum now held by the trustee which, the parties agree, constitutes the portion of the refund attributable to earnings prior to filing.

Dated: January 20, 1972.

/s/ Albert C. Wollenberg
United States District Judge